

Microinsurance in Spain: *The race starts now!!*

A consequence of the economic crisis, the new face of Spanish society makes it possible to introduce innovative products such as microinsurance, which can be found in developing countries. This document analyzes the opportunities offered by this new market, and the required characteristics that will make microinsurance suitable for implementation in Spain. Examples are provided.

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Einstein said that crises are a blessing for both people and countries as they bring progress. In fact, that is either the case, or we need to make it that way. There is no other alternative.

This crisis has made it clear that we need to reinvent ourselves, look for sustainable products, and acknowledge that it is vital to have a majority of middle class individuals; otherwise, there is no market. And without a market, the system as it stands is unsustainable.

Currently, the base of the population pyramid is growing in size, as people move from the middle class to low-income classes.

Therefore, it is essential that stakeholders (public and private institutions) consider measures for innovating with products. These products must ensure the (current or future) wellbeing of the middle class. They must also help to increase the number of people in this class by offering savings and insurance options that allow low-income individuals to increase their purchasing power, without being subject to risks that send them to the poverty threshold, or push them further away from the middle class.



ILLUSTRATION STOCK

For people between the poverty threshold and lower classes, there is a new set of financial products called micro: microinsurance and microcredit or, more generally, microfinance.

Microinsurance specifically (hereinafter MI) has been applied in developing

countries for some decades now. The aim is to break the cycle of poverty, to make low-income people less vulnerable, and to be a driver for these people to entrance and control their own assets and revenue. They are no longer solely (or not solely) dependent on aid and grants; they can rely

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on instruments that allow them to shape their own finances, rather than rely on donations, loans, and government or NGO aid, which can occasionally lead them to fall prey to usury.

As an example we would like to mention the four cases described by Carlos Ruano Espí in his thesis *Invitación al microseguro (Invitation to Microinsurance)*^[1]: La Equidad in Colombia and AIG in Uganda (life microinsurance), three health insurance cases in India, two cases of corporate multi-peril microinsurance in France, and two cases of parametric agricultural microinsurance. These examples include several life and non-life insurance business lines.

Because they are next door to us, we will look at the cases in France in more detail. As described in this thesis, there was a collaboration agreement between two insurance companies and a charity association focused at microcredit. The agreement was to provide multi-peril insurance to individuals starting their business from home, and multi-peril insurance to individuals who chose a site for their new business. The offer comprised insurance for less than one euro/day with the added value necessary for these products, and a support service for the first three years, at the end of which traditional insurance was suggested. But this initiative by AXA, MACIF and ADIE is not unique. Entrepreneurs de la Cité offers similar products. In both cases, a key factor is to provide support and guidance to start the business, and to help the new businesses to adopt a good marketing strategy.

Recently, these types of products have been frequently mentioned as a preventive

measure in case of personal adversities after natural disasters such as Typhoon Haiyan or events linked with climate change.

On November 16, 2013 Francisco Javier Garaoya wrote a new post on his blog *El microseguro inclusivo* of Red Cumes (FUNDACIÓN MAPFRE). On this occasion, he talked about climate change and microinsurance, and how the latter mitigated the disastrous consequences of drought in Ethiopia by means of parametric agricultural microinsurance: «An example of success is the program implemented last year to alleviate the effects of drought in Ethiopia. When satellites recorded drought conditions, more than 12,000 farmers received a total of \$322,772 via the R4 Rural Resilience Initiative, an index-based agricultural microinsurance program



adapted to climatic specificities of developing countries.»^[2]

So, we have the chance to innovate with new products (to reach a wider audience), and to develop these products in compliance with corporate social responsibility and social marketing policies.

And do not forget that this involves not only providing insurance to low-income individuals but also helping them move to the middle class threshold (thus expanding the traditional market) by mitigating the damage and effects of certain events on their savings, and the need to reduce current or future savings due to loans (both from the market and family and friends).

Consequently, we are talking about reverting current social trends. This is the premise of the microinsurance products mentioned above, which we can already find in France.

This is a huge market for insurance products, where the force of numbers is applied naturally and where earnings can be expected. But these are not short-term earnings. Due to this market's peculiarities, we should expect losses in the first few years. Implementation will be slow as there is a long way to go; we need to research the market thoroughly, and determine for which needs people are willing to pay a micropremium. We need to generate demand. And while we create a market, we are taking risks linked to little distribution, high probability of adverse selection and fraud. However and unlike traditional insurance, we cannot apply premium loading as that type of product would not appeal to our target market. A priori, these initial effects can be corrected, alleviated or turned into investment by:

- Bearing initial losses via Corporate Social Responsibility: What better investment could there be for CSR policies of insurance companies than to create low-cost products for low-income families?

- Beginning with the creation of group microinsurance with compulsory underwriting «This mechanism limits the scope for adverse selection and allows more relaxed underwriting»^[3].

- Creating alliances with public institutions or non-governmental organizations, such as between DKW and Fundación Tierra Nueva to provide health microinsurance to people in southern Quito (Ecuador).

And we cannot forget reinsurance, coinsurance and other methods of risk division.

The first companies to stimulate these markets will take the greatest technical or underwriting risks, and will face the biggest product introduction expenditures; however, they will become the leaders of this major potential market.

Consequently, there is a two-fold perspective of microinsurance: financial driver and financial opportunity. In the words of Craig Churchill^[4]: «Regardless of whether one is looking at microinsurance from a social-protection or a market-based approach, the body of the insurance scheme, its basic operations, will be largely the same».

When we plan these types of products for Spain (a non-developing country), we need to not only analyze the product in detail as per its current definition and operation in other countries, but also to

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adjust some aspects to adapt it to our current system, situation and culture.

This article is not aiming to describe the different approaches to expressing the concept of poverty in numbers. There are various definitions and classifications of poverty, depending on whether we talk about relative or absolute terms, currencies or percentages. Based on the definition contained in almost all literature about microinsurance, i.e. the World Bank's definition, poor people live on less than \$730 per year. This measurement cannot be applied to poverty in Spain. Here the poverty threshold is measured pursuant to recommended Eurostat criteria, and using the statistical Median (not sensitive to extremes). This measurement is 60 percent. This is a relative measurement based on income distribution in the previous year; it is not fixed (it varies depending on the median, and the median varies depending on income distribution).

According to interim 2013 data from the Spanish Survey of Living Conditions (ECV)^[5], by the National Statistics Institute (INE), the poverty threshold for single-person households is 7,040 euros/year (about ten times the WB definition).

This survey also concludes that «40.9 percent of homes are not prepared to face unexpected expenses», which represents an increase on previous years.

It is also mentioned that «16.9 percent of households say that they struggle to make ends meet».

This information alone leads to a wealth of questions and answers about business and social development. We should research what type of unexpected expenses these families are faced with: What is their total value? What measures are taken to



prevent this situation? How it is handled? By tapping into savings? By taking out new debt and incurring new obligations on this loss, with no future growth or benefit?

As for the difficulty in making ends meet: could this result in delays in premium payments, terminations, cancellations? What premiums can be offered which do not put a strain on families? How can we offer payment systems to prevent non-payments?

For instance, we could consider very low monthly premiums. Maybe even premiums in installments by dividing the risk rather than the premium.

And there is also the big question, the big concern for all insurance companies: moral risk, fraud, insurance misuse. What measures can be taken to prevent misuse? We can look into *bonus-malus* systems, income participation systems, rewards for no claims, and additional services that add value



to insurance so that clients receive depending on what they pay, rather than in the event of an unexpected situation.

Given all these aspects, would this potential market take out insurance? Would they be willing to pay a premium, however small, to insure an uncertain event? How far does the insurance culture go in Spain? Undoubtedly, financial and insurance culture in Spain is a lot more widespread and has penetrated deeper into the market than in any other country where microinsurance is being developed (excluding minor examples in countries such as France, as seen above). Insurance is a concept known by everyone, even if this is restricted to compulsory automobile insurance.

Additionally, unlike developing countries where microinsurance is being used and implemented, in Spain we find no problems linked to the distribution channel.

There are no issues, from online contracting to distribution to the wider public to underwriting via local agents and brokers (and many rural brokers). However, this does not mean that we should not look for new distribution channels, and innovate to reach everyone.

To this end, we should consider the possibility of microinsurance regulation allowing for a wider range of insurance brokerage means, in addition to brokers and agents. As we will see at the end of this article, one of this product's characteristics is its simplicity. Simplicity associated with management which does not necessarily comply with the standards of traditional insurance. Consequently, being a broker would not be a requirement to market these products. They could be provided by local businessmen or distributed by commission agents.

Additionally, there are also certain insurance contract issues, such as suspending coverage in case of non-payment. These are sensitive people; we must act with caution and manage recoveries in a friendly, accessible and flexible fashion. Pending premiums should be deducted from indemnity in case of claims, or premium payments should be facilitated.

All people involved in this new concept agree that microinsurance contracts must be: simple, clear, with not many or no exclusions. Or as per the definition of Michael J. McCord, these products must be S.U.A.V.E (Simple, Understood, Accessible, Valuable, Efficient)^[6].

And how do we handle this? It may not be easy to believe it, but writing simple and clear insurance contracts with not many legal details is a major challenge. Therefore, coverage must be correctly defined and

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established in its own definition, without having to refer to the exclusions and «small print». Instead of All Risk contracts with several pages of exclusions, we must consider summary contracts listing individual coverage together with its specific definition and scope.

The issue of sensitivity also applies to claim management and, consequently, damage appraisal. These groups cannot wait during lengthy claim management periods. They try to protect themselves from their vulnerability by paying premiums during an undetermined period of time until the insured situation occurs; in case of a claim, they cannot use other resources, and each day without help brings a further decrease in their income. For this reason, we must not think in terms of traditional claim processing, request for documentation, strict deadlines, etc. We have to see beyond this, we need to act quickly with minimum or no documentation, and with help and guidance to gain access to any indispensable documents.

Appraisal work is also reinvented: appraisers and repairers may, and should, potentially advise and help in documentation management, in a direct and proactive manner. Similarly, we need to find ways of repairing damage, mitigating and educating in incident prevention, by conducting proactive risk checks to forestall future events.

Indemnity must also be redesigned. First, because it becomes a means of providing advice, help, prevention and education to policyholders. Companies get closer to clients and offer their assistance. Additionally, we must invent other means of indemnity to truly compensate policyholders and restore them to their

status before the claim, with no proportional rules (applied due to an underwriting error); we must also use the concept of depreciation with extreme caution. Economic indemnity often does not allow policyholders to acquire goods with the same level of usefulness as the affected good. Sometimes this is due to a lack of search opportunities. This new concept must comprise repairs over economic indemnity. Repairs until the affected good is restored to its level of usefulness.

Another way of indemnifying by restoring the level of usefulness involves managing the acquisition in the second-hand market of goods with similar characteristics and age. Claim management must be completely reinvented.

Readers who did not know these products before reading this article must now have inferred that this insurance product is not about reducing traditional insurance coverage but rather about adjusting it to a new low-income client profile with different risk situations. The insured sum will be lower and so will the premium. But this is not about reducing coverage or the insured sum.

This is a full product meeting the exact needs of low-income individuals; naturally, the causes of risk and coverage needs will be different from the traditional market. A common error is to liken this type of insurance to low-cost insurance, or to think that this type of product can only include life or group risk insurance.

Given the characteristics of this new market, the product must be adapted both in terms of costs and risk analysis and concept, composition, definition, contracting, management and handling.

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some microinsurance products that could work, although we obviously need to conduct appropriate market research and study the needs of low-income individuals. Nevertheless, we can gather some information from aggregate economic data, and assess microinsurance based on general figures such as unemployment.

Unemployment insurance is not a new product. Given the temp work, irregular and unstable employment market, we cannot offer lower premiums so that this market can access this type of insurance. However, if we consider low-income individuals with a more or less secure job

(indefinite term contracts and contracts for works and services, people who demonstrate work continuity over several years even if in different positions, etc.), we can define shortage periods. Also, for instance, we can design a product that covers long-term unemployment rather than unemployment in itself: compensation is provided in case of employment for longer than two years, or at the end of the contributory benefit and after no less than six months, etc. This solution would be a small temporary sum, for example, of a previously-agreed total (e.g. 300 euros) to complement potential government benefits (the well-known 400 euros) for a previously-agreed period. One of the advantages of this type of microinsurance would be a quick first payment, as compared to a long waiting period for government benefits. The policyholder's vulnerability would thus be reduced, as intended with MI.

This product should include a guidance service and assistance in looking for work from the very start of unemployment. This would often prevent the end of the contributory benefit (and beginning of insured income collection), and provide added value seen and received by the clients.

Unemployment affecting several household members is another issue that can be addressed by means of microinsurance. It would be feasible to design a product offering temporary income for a previously-agreed total if several household members were unemployed (both parents living with minors, two members of a family with three working adults, etc.). This product should also include a guidance service as per the example above, with the possibility of combining both products.

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While designing microinsurance, it is very important to provide added value to the product. Clients will be aware of this when they need to make a payment or when an incident occurs, and will also receive some kind of service from the company, for added value.

After major disasters there are many people with no property insurance covering this risk, via the Spanish Consortium for compensation of risk and insurance (*Consorcio de Compensación de Seguros*). They may not want to make a high annual payment for typical damage caused by water or theft or for esthetic damages, etc., as covered by a SME or home multi-peril policy. But the same people would have paid a lower premium for a Consortium-covered risk, and even for certain major risks not covered by the Consortium. High-risk insurance is high microinsurance. And big

insurance companies are already looking into this by means of research: Munich Re and Swiss Re (through an *ad hoc* foundation, the former cooperates with the ILO in work groups to research MI).

In terms of group insurance products and so as to mitigate the effect of adverse selection, we can conceive group insurance for single-parent families: an assistance service for the children and home in case of serious illness, hospital admission, etc. with an aim of avoiding that children suffer even more in these difficult situations.

We should also consider self-employed groups, house services (in-house staff, hourly work), etc.

Eviction insurance covering a rental service between three to six months if the family is evicted due to non-payment. This coverage can be marketed by a banking institution to their mortgage holders, in



collaboration with an independent insurance company and legal consulting and mediation services.

In Life, there is a major microinsurance niche covering differences in the purchasing power of people who are starting to receive contributory or non-contributory pensions, based on their last salary.

There are already some examples of these products in the Spanish market. ARAG offers damage defense and claim microinsurance, and Adeslas Segur Caixa provides dental assistance microinsurance. However, they should be studied in detail to confirm that they are examples of microinsurance rather than low-cost insurance. In the first case, we were not able to obtain more information about this product, either online or by any other means, to identify «microinsurance» characteristics. In the second case, the company's website offers a cheap dental product with a range of «traditional» general conditions, which do not seem to be a good example of a simple product. However, the product is not offered as microinsurance, even if this was the designation for which it won the 2012 award for innovation in insurance, from the association ICEA.

In any case, examples will follow from studying the population and its needs and requirements. This type of insurance should always provide added value to ensure a close relationship between companies and policyholders while the contract is in effect. The race has already started. ■

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